CALIFORNIA DEPARTMENT OF INSURANCE

TOTAL DISABILITY DEFINITION IN STANDARD CREDIT POLICY FORMS REGULATIONS

Title 10, California Code of Regulations, Chapter 5, Subchapter 2
Article 6.9

FINAL STATEMENT OF REASONS

DATE: February 28, 2008
REGULATION FILE: REG-2007-00030

INTRODUCTION

Credit disability insurance pays some or all of a debtor's monthly loan payments when he or she becomes unable to work because of sickness or injury. The regulations governing credit disability insurance policy forms covering revolving accounts and loans of ten years duration or less are set forth in Title 10, California Code of Regulations, Chapter 5, Subchapter 2, Article 6.9 (§§ 2249.1 – 2249.16). That Article implements the system of standard credit life and disability insurance policy forms required by Insurance Code § 779.27. Insurers must use the standard forms when possible and they need not be approved by the Department before use. The Insurance Code section also authorizes "non-standard" forms that are also governed by the regulations and which must be approved before they are used. The policy forms are drafted by assembling appropriate provisions from blocks of standard text set forth in the regulations.

The principal purpose of this rulemaking action is to make more specific the existing standard "Definition of Total Disability" (paragraph PG 1of § 2249.12) in the cited regulations so that it more accurately reflects California case law. This is necessary because insurers and disability claimants cannot rely upon the existing definition as an adequate statement of current California law.

This action also corrects an unrelated error in the amendments to the regulations that became effective on November 1, 2006, pertaining to Notices of Proposed Insurance. Finally, the regulations are changed to waive refiling of non-standard forms that were modified solely to comply with the amendments made by this action and to specify a mandatory compliance date.

Note that the amended regulations are used almost entirely by insurance policy form drafters who are either employees of or consultants to insurance companies. Such persons are familiar with terms in the regulations that may be abstruse to those outside the credit disability insurance business.

SPECIFIC PURPOSE AND REASONABLE NECESSITY

The specific purpose of each adoption and the rationale for the Commissioner's determination that each adoption is reasonably necessary to carry out the purpose for which it is made are set forth below. "Certificate," as used herein, means "individual policy and group certificate" except where the context requires otherwise.

1. Clarify the "Definition of Total Disability. The existing regulations establish a standard "Definition of Total Disability," which is used to determine whether a disabled debtor qualifies for benefits under the Total Disability Insurance Benefit provision (if any) in a credit insurance certificate subject to the regulations. The existing "Definition of Total Disability" (§ 2249.12, paragraph PG 1) establishes two standards for determining total disability, depending upon how long the debtor has been disabled. For the first 18 months of disability, the debtor is deemed to be totally disabled if s/he is unable to work in "(his or her) occupation". After that, the debtor is deemed to be totally disabled only if s/he is unable to work in "any occupation", as defined. The definition is little changed from its appearance in the first version of the regulations that was adopted in 1978.

California case law has long established minimum criteria for what constitutes "total disability" in private disability insurance products. The existing "Definition of Total Disability" only generally reflects those criteria and it omits specific elements thereof that appear in the case law.

The leading California case on what constitutes a permissible definition of total disability in private insurance policies and certificates is Erreca v. Western States Life Insurance Co. (1942) 19 Cal.2d 388. The California Supreme Court held that total disability for private insurance purposes was ". . . a disability which prevents (the insured's) working with reasonable continuity in his customary occupation or in any other occupation in which he might reasonably be expected to engage in view of his station and physical and mental capacity." Erreca at 394. The court explains further: "[T]he term 'total disability' . . . means such a disability as renders the insured unable to perform the substantial and material acts necessary to the prosecution of a business or occupation in the usual or customary way. Recovery is not precluded under a total disability provision because the insured is able to perform sporadic tasks, or give attention to simple or inconsequential details incident to the conduct of business. (Citations omitted) Conversely, the insured is not totally disabled if he is physically and mentally capable of performing a substantial portion of the work connected with his employment. He is not entitled to benefits because he is rendered unable to transact one or more of the duties incidental to his business."

In 1984, the Third District Court of Appeal elaborated on the Erreca total disability definition in Moore v. American United Life Insurance Co. (1984), 150 Cal. App.3d 610 (petition for hearing by the California Supreme Court denied). The Court of Appeal approved a challenged jury instruction that iterated the elements of total disability established by Erreca but made the Erreca elements of "physical and mental capacities" more specific by adding "age, education, training, and experience." Moore at 632.

In the Department's opinion, the best summary of current case law for the purpose of this rule-making action is the jury instruction approved in Moore. That instruction stated that total disability " . . . is defined as a disability that renders one unable to perform with reasonable continuity the substantial and material acts necessary to pursue his usual occupation in the usual or customary way or to engage with reasonable continuity in another occupation in which he could reasonably be expected to perform satisfactorily in light of his age, education, training, experience, station in life, physical and mental capacity." Moore at 632.

The language in the existing definition of Total Disability pertaining to "usual occupation" disability states that the insured must be ". . . not able to perform the major duties of (the insured's) occupation because of sickness or accidental injury." It omits the references to "reasonable continuity", "substantial and material acts" and "in the usual or customary way" found in the portion of the Moore definition pertaining to inability to perform one's "usual occupation". It is necessary that these major qualifications of the terms "perform" and "major duties" be included in the standard definition of total disability if it is to be interpreted by claimants and insurers in accordance with case law. The first sentence of the existing paragraph PG 1 of § 2248.12 is thus redrafted to include the cited elements.

The phrase "substantial and material acts," in the amended definition, is an important part of the Erreca and Moore definitions but it is inconsistent with the drafting style of the existing regulations wherein the Department has tried to avoid legalistic words and terms of art. Thus, a new sentence clarifying the phrase in somewhat easier-to-understand terms is added to the end of the "your occupation" portion of the definition to assist debtors with interpreting it. The new sentence is derived from language that has been proposed by insurers and approved by the Department in filings of non-credit "disability income" insurance products. In the Department's opinion, it is consistent with Erreca and Moore even though it does not paraphrase language in the cases.

The language in the existing definition of Total Disability pertaining to "another occupation" disability states only that the insured must be ". . . not able to perform the duties of any occupation for which (the insured is) reasonably qualified by education, training or experience." It omits the references to the terms "reasonable continuity", "reasonably be expected to work satisfactorily," "age" and "station in life, physical and mental capacity," found in the portion of the Moore definition pertaining to inability to perform "another occupation". It is necessary that these major qualifications of the words "perform" and "duties" be included in the standard definition of total disability if it is to be interpreted by claimants and insurers in accordance with case law. The second sentence of the existing regulation definition is redrafted and a third sentence is added to include these elements. The final sentence in the existing definition is retained as the final sentence in the amended definition.

2. Correct Error in List of Block Numbers Section. Existing Section 2249.9 specifies the text blocks that comprise the standard certificates and the Notices of Proposed Insurance (both denominated by "Identification Number" or "ID #") used with them. (Note that the cited Code Section also applies to Notices for individual policies. § 2249.6(h).) Existing Paragraph #11 of § 2249.9 specifies that Notice of Proposed Insurance Block A-2 (from § 2249.13) shall appear in Notices used with Identification Number 11 certificates, which provide both life and disability coverages. However, Block A-2 refers only to life insurance; Block A-1 refers to both life and disability.

It is necessary to change the standard ID # 11 Notice to refer to both the coverages provided by an ID # 11 certificate so as to improve the internal consistency of the regulations. Thus, Paragraph #11 of § 2249.9 is amended to call for Notice of Proposed Insurance Block A-1 as the first paragraph for the Notice for the ID # 11 certificate.

3. Waive Re-filing of Changed Policy Forms. Existing regulations require that non-standard policy forms be approved by the Department before their issuance. Previous amendments to the subject regulations, effective in 2006, required insurers to make many changes in their forms by November 1, 2007, and the Department was processing the resulting refilings of non-standard forms while, at the same time, it was developing these amended regulations. The Department was concerned about the burden that would have been placed on insurers and the Department by requiring another round of re-approval of these forms because of the changes adopted in this action. In addition, the changes in policy forms required by the amendments are straightforward and, in the Department's opinion, should require little supervision from us to ensure that they are made correctly.

Section 2249.2 is amended by adding a new Subsection (e) to waive the refiling for approval of previously approved policy forms that have been changed solely to reflect the changes in the regulations made by this action.

4. Amend Compliance Date. Existing Section 2215 prescribes dates by which forms subject to the regulations must have been brought into compliance with the original regulations and with the regulations as they were amended in 2006. It does not provide similarly for the changes in policy forms that will have to be made because of this rule-making action. Section 2215 is amended to provide for a one-year period starting with their effective date for compliance with the adopted amendments.

ALTERNATIVES

The Commissioner must determine that no reasonable alternative considered by the Commissioner or that has otherwise been identified and brought to the attention of the Commissioner would be more effective in carrying out the purposes for which the amended regulations were proposed or would be as effective as and less burdensome to affected private persons than the adopted regulations. One alternative would have been not to amend the regulations as proposed, so that insurers would have had to develop their own definitions of total disability and file or refile for approval, every credit policy form that contained a total disability benefit. This would have more burdensome on the industry and the Department than adopting the proposed amendments in the Department's opinion. The other alternative would have been to allow insurers to continue using the existing inadequate definition of total disability and to trust that insurers would apply the case law in their claims administration. This alternative would have denied to insureds an adequate explanation of the standards that the insurers would use in administering their disability claims. The Commissioner is aware of no other reasonable alternative to the adopted amendments that would be less burdensome on the entities subject to the regulations. The Commissioner invited public comment on alternatives to the amended regulations in the Notice of Proposed Regulatory Action and no such comments were received.

ECONOMIC IMPACT ON SMALL BUSINESS

The Commissioner identified no reasonable alternatives to the amended regulations, nor were any such alternatives otherwise identified and brought to the attention of the Department, that would have lessened any impact on small business.

The Commissioner has determined that the amendments will affect only those small businesses that distribute or market credit life and disability insurance to their customers. Such businesses will have to take steps to ensure that they use the proper, updated policy forms as supplied by the insurers. The costs of that impact are unquantifiable.

Insurers are not small businesses pursuant to Government Code § 11342.610(b)(2).

IDENTIFICATION OF STUDIES

No specific studies were relied upon in the adoption of the amended regulations.

SPECIFIC TECHNOLOGIES OR EQUIPMENT

Adoption of these regulations does not mandate the use of specific technologies or equipment.

PRENOTICE WORKSHOP FOR DISCUSSIONS

The Commissioner did not conduct prenotice public discussions pursuant to Government Code § 11346.45 because the proposed regulations did not involve complex proposals or a large number of proposals that could not have easily been reviewed during the comment period. Thus, no input obtained during prenotice public discussions was considered in formulating the adopted revisions.

TABLE OF CASES

Erreca v. Western States Life Insurance Co. (1942) 19 Cal.2d 388.

Moore v. American United Life Insurance Co. (1984), 150 Cal. App.3d 610.

#433380v1